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RHMCSUU/DEPT OF ENERGY WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHDC
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UNCLAS SECTION 01 OF 03 LAGOS 000188

SENSITIVE
SIPDIS

FOR GABORONE PASS PDROUIN
FOR BAGHDAD PASS DMCCULLOUGH
COMMERCE FOR KBURRESS
TREASURY FOR DPETERS, RHALL, RABDULRAZAK
STATE PASS USTR FOR LISER, AGAMA
STATE PASS OPIC FOR ZHAN, MSTUCKART, JEDWARDS
STATE PASS TDA FOR EEBONG, DSHUSTER
STATE PASS EXIM FOR JRICHTER
STATE PASS USAID FOR NFREEMAN, GBERTOLIN
USDOC FOR 3130/USFC/OIO/ANESA/DHARRIS
USDOC FOR USPTO - PAUL SALMON
USDOJ FOR MARIE-FLORE KOUAME

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TAGS: EFIN EINV ETRD PGOV NI
SUBJECT: NIGERIA: LAGOS FINANCIAL ELITES CRITICIZE CBN MONETARY POLICIES, SUPPORT SOLUDO REAPPOINTMENT

Ref: A) Abuja 614
B) Abuja 578
C) Lagos 154
D) Abuja 455
E) Lagos 92

¶1. (SBU) Summary: As the financial crisis and economic downturn deepen in Nigeria, EconOff met Bismarck Rewane, CEO of Financial Derivatives Company and member of the President Economic Steering Committee, on April 1 and Doyin Salami, Professor at the Lagos Business School and member of the President Economic Management Team, on April 2 to get their assessment on the viability of the Central Bank of Nigeria's (CBN) monetary policies, the possibility of fiscal stimulus measures, and the prospect of CBN Governor Chukwuma Soludo's reappointment in May 2009. According to these Lagos-based financial experts, the CBN's interest rate controls will prove to be ineffective and, furthermore, will spur the activities of the existing shadow banking system and potentially crowd out middle-tier banks. The interest rate controls have also signaled a backpedaling in progress made by CBN Governor Charles Soludo in the past years. These experts also believe that the CBN's adoption of expansionary monetary policies in April to ease liquidity concerns would not address structural problems underlying the banking sector, and that the Government of Nigeria (GON) should not adopt any fiscal stimulus measures in response to the economic slow down. Contrary to popular opinion, Soludo might be positioning himself for reappointment by selling himself as the most viable candidate, one not to be replaced at the peak of a crisis. End Summary.

Interest Rates Controls Ineffective

¶2. (SBU) Leading Lagos-based financial experts Bismarck Rewane and Doyin Salami agreed that the new interest rate regime put in place by the Central Bank of Nigeria (CBN) will not work in theory or in practice. In theory, Salami argued that setting a deposit rate cap of 15 percent will not work if inflation hovers about 15 percent in the near term future. (Note: The 15 percent deposit rate cap is 40

basis points above the February inflation rate of 14.6 percent. End note) According to Rewane, the CBN's imposition of a 22 percent lending rate cap represented a static solution to a dynamic equilibrium issue, and while the cap might be considered a fair rate, it does not capture the market risk premium. Rewane pointed to the wide gap between the 2.5 percent rate offered on risk-free treasury bills and the inter-bank lending rate of about 30 percent as evidence of the high risk premium priced into lending among the banks. Since the 22 percent lending ceiling is significantly below the market inter-bank lending rate, the interest rate cap would neither increase bank lending to the real sector nor to each other, he argued.

Controls to Spur Shadow Banking
System, Crowd-out Middle Tier Banks

¶3. (SBU) Rewane also told EconOff April 1 that the new cap on interest rates has already created a shadow market. Banks that were desperately in need of deposits and were offering high deposit rates, primarily middle tier banks, would be willing to pay higher than 15 percent off the record in order to attract or retain depositors. There is also a credible fear that with a ceiling on deposit rates, discerning depositors would move from middle tier banks such as Spring Bank, Skye Bank, and Sterling Bank to stronger, better capitalized banks such as First Bank, Zenith Bank, and Guaranty Trust Bank. As a result, a dwindling deposit base, along with credit line recalls and reductions as well as projected increased public sector spending in 2009, could result in a crowding out of the middle tier banks. On the lending side, Rewane argued that banks would charge extra fees to desperate borrowers willing to

pay more than the 2 percent fixed fee cap. In addition, Salami said, despite the 2 percent fixed fee, some banks might set fees at a rate proportional to the loan portfolio, a term that would be accepted by borrowers desperate for capitals.

Expansionary Policies Will Not Address
Structural Problems in the Banks

¶4. (U) On April 8, the CBN adopted a number of expansionary policies to ease liquidity problems, namely reducing its monetary policy rate from 9.75 to 8 percent; cutting the cash reserve requirement for banks from 2 to 1 percent; and reducing banks' minimum liquidity ratios from 30 to 25 percent. According to an April 9 report by Eurasia Group, a political risk research firm, the decision to loosen monetary conditions despite high and rising inflation was surprising. These policy steps would not address the underlying structural problems in the banking sector, namely banks over-leveraging their balance sheets during the boom cycle resulting in trillions of naira of toxic loans.

No Fiscal Stimulants

¶5. (SBU) Professor Salami argued against the GON's adopting any sort of fiscal stimulus. According to Salami, a member of the Economic Management Team (EMT), President Yar'Adua had broached the idea of introducing fiscal stimulants in a meeting with the EMT. However, Salami said fiscal stimulus would not make sense for Nigeria as a budget deficit was projected for 2009 due to falling oil prices. (Note: Minister of Finance Mansur Muhtar announced on March 24 that the 2009 budget deficit would be around 3.02 percent of GDP, while analysts projected the deficit to be around 7 percent of GDP (Ref B). End note) Fiscal stimulus measures are used to cushion the economy from events happening outside of the budgetary cycle, Salami argued, and not for an already budgeted economic slowdown. With respect to Governor Soludo's announcement that the GON would borrow roughly Naira 1.6 trillion (USD 10.5 billion) from local banks to finance the budget deficit, Salami argued that such an amount could only come from International Financial Institutions (IFIs) and not from local Nigerian banks. According to Rewane, Naira 1.6 trillion (USD 10.5 billion) amounts to about 40 percent of the current aggregate loan book of the banks. For that reason, borrowing such

an amount from local banks would be unrealistic given that most banks are struggling with dwindling profits, tightening credit lines, and an increasing level of defaults.

GON Without Policy Focus

¶6. (SBU) Doyin Salami expressed concerns over the apparent lack of policy focus at the leadership level. According to Salami, it is impossible to describe the GON when it comes to fiscal and monetary policies, in other words, whether they are conservative, centrist, or liberal. Soludo's monetary policies have been all over the board and have not helped in boosting private sector confidence. In general, Rewane and Salami agreed that with the interest rate controls, Soludo has effectively backpedaled on the hard-won reforms and progress in the financial and banking sector.

Governor Soludo Wants to Keep His Job

¶7. (SBU) While discussions are underway regarding the short list for Soludo's replacement, Rewane believes that Soludo is campaigning for another term and that the latest series of CBN measures were implemented to boost public confidence and his popularity. Since it is widely understood among top GON officials, including Soludo, and industry experts that no CBN policy can save Nigeria from an

economic slow down, Soludo has caved in to populist demands and, thereby, implemented populist policies such as the interest rate cap. Despite Soludo's shortcomings, Rewane said certain quarters in the government and private sector are lobbying for Soludo's reappointment in order to minimize the risks of changing the guard at the peak of a financial crisis and of having a less-competent individual taking over. He suggested that Managing Director of First Bank of Nigeria, Sanusi Lamido, who is well known to the Mission, would be a welcome substitute for Soludo.

¶8. (SBU) Comment: At the heart of the problem is enforcement. In an economic environment where banks are desperate to shore up their deposit portfolios and borrowers are cash-strapped, both sides willingly engage under the table activities, making a banking system that was already under question for its accounting practices and balance sheets even more dubious. Soludo had told Ambassador that he is tired but will reconsider another term if asked (Ref C). If Rewane and Salami are correct, Soludo's attitude might be a smoke screen and his apparent pandering to populist appeals is to position himself as the most viable candidate. It is interesting to note that Rewane and Salami, two of Soludo's harshest critics and who have repeatedly called for his resignation, now seem to welcome the prospect of the Governor's reappointment. This change can be attributed to their recognition that there is no better candidate than Soludo to lead the CBN. Nonetheless, the CBN's latest monetary policy measures have left at least two prominent financial experts confused as to the rationales, motivations, and potential repercussions for Nigeria's economy. End comment.

¶9. (U) This cable has been cleared by Embassy Abuja.

Blair